



STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/16/01	Bill No:	SB 312
Tax:	Cigarette and Tobacco Products	Author:	Alpert
Board Position:		Related Bills:	AB 224 (Matthews)

## BILL SUMMARY

Among other things, this bill would clarify that a distributor may exclude the wholesale cost of tobacco products returned by a customer from the wholesale cost used to calculate the tax, or may claim a refund of the excise tax paid on the distribution of the tobacco products or take a credit on its return in lieu of a refund.

## ANALYSIS

### Current Law

Under existing law, Section 30123 of the Cigarette and Tobacco Products Tax Law imposes an excise tax on the distribution of tobacco products, based on the wholesale cost of the tobacco products, at a rate which is equivalent to the combined rate of tax imposed on cigarettes. Section 30131.2 imposes an *additional* tax on tobacco products based on the wholesale cost of the tobacco products distributed at a rate which is equivalent to the additional 50-cent per pack tax on cigarettes also imposed by this section. The tax rate on tobacco products, which is set annually by the Board, is currently set at 54.89 percent for the period July 1, 2000 through June 30, 2001.

Section 30177 of the Cigarette and Tobacco Products Law requires the Board to refund or credit the tax paid on the distribution of tobacco products if the products have become unfit for use or unsalable and have been returned to the distributor for credit or have been replaced. A distributor must provide the Board with proof of that return or destruction.

### Proposed Law

This bill would amend Section 30123 to provide that the wholesale cost used to calculate the amount of tax due does not include the wholesale cost of tobacco products if:

- The tobacco products were returned by a customer during the same reporting period the tobacco products were distributed, and
- The distributor refunds the entire amount the customer paid for the tobacco products in either cash or credit.

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This bill would also amend Section 30177 by removing existing refund and credit provisions for returned tobacco products and incorporating similar provisions into new Section 30176.2. Section 30176.2 would require the Board to refund or credit a distributor the excise tax paid on the distribution of tobacco products when the distributor refunds the entire amount the customer paid for the tobacco products in either cash or credit. In addition, Section 30178.2 would allow a distributor eligible for a refund to claim a credit against tax owed on its return. Therefore, this bill would require the Board to refund or credit a distributor the tax paid for tobacco products that are returned for *any* reason, whether or not such products have become unfit for use or unsalable.

A refund or credit of the entire amount would be deemed to be given when the purchase price less rehandling and restocking costs is refunded or credited to the customer.

In addition, this bill would amend Section 30005.5 to revise the definition of “untaxed tobacco product” to include any tobacco product that was distributed in a manner that resulted in a tax liability, but that was returned to the distributor after the tax was paid and for which the distributor has claimed a deduction, refund or credit.

### **Background**

In November 1988, California voters approved Proposition 99, the *Tobacco Tax and Health Protection Act*. Proposition 99 added Section 30123, effective January 1, 1989, which imposes an excise tax upon the distribution of tobacco products based on the wholesale cost of those tobacco products at a rate that is equivalent to the combined rate of tax imposed on cigarettes. Proposition 99 also added Section 30126, which requires the Board to annually determine the tobacco products tax rate. The measure enacted by the voters was intended to provide *equitable tax treatment* of cigarettes and tobacco products.

Proposition 10, the *California Children and Families First Act of 1998*, was passed by California voters on November 3, 1998. Proposition 10 added Section 30131.2, which imposes an *additional* excise tax on the distribution of cigarettes and a corresponding additional tax on the distribution of tobacco products at a rate that is equivalent to the additional cigarette tax.

In 1998, Assembly Bill 2075 (Chapter 815, Granlund) amended Section 30177 of the Cigarette and Tobacco Products Tax Law to require the Board to refund or credit the excise tax previously paid by a distributor on tobacco products which become unfit for use or unsalable. As intended by Proposition 99, AB 2075 eliminated a disparity between cigarettes and tobacco products by authorizing distributors of the latter to also receive a tax refund or credit for excise tax paid on tobacco products that have become unfit for sale or use. Assembly Bill 2075 was sponsored by the California Distributors Association.

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**COMMENTS**

1. **Sponsor and purpose.** This bill is sponsored by the California Distributors Association and is intended to correct an oversight in the drafting of the refund provisions for tobacco products that were added to the Revenue and Taxation Code pursuant to AB 2075 (Chapter 815, Statutes of 1998).
2. **This measure would clarify existing practice concerning tobacco products returned by a customer.** Under existing law, the tax is imposed upon every distributor upon the distribution of untaxed tobacco products. Therefore, once tobacco products have been distributed, they are always considered taxed - even if the customer subsequently returns them. Returned tobacco products considered fit for use or salable are typically resold to another customer. However the tax is technically not imposed upon that subsequent sale because it is not a “distribution”. “Distribution” is defined, in part, to include the sale or use or consumption of untaxed tobacco products in this state.

It is Board staff’s understanding that it is the practice of distributors to refund the tax to a customer for tobacco products returned and to reimburse itself for the tax from a new customer when the returned tobacco products are subsequently resold. For purposes of reporting, distributors have been deducting the wholesale cost of tobacco products returned from the wholesale cost used to calculate the amount of tax, and reporting the tax when the returned product is resold.

However, current law technically does not authorize this practice because a distributor cannot take a deduction on its return, nor can it claim a refund, for those tobacco products returned by a customer that are fit for use and salable. Nor does current law impose the tobacco tax on the subsequent sale since it is not a distribution of “untaxed” tobacco products. The Board has been allowing distributors to report in this manner because the timing difference between the distribution and redistribution of returned tobacco products is considered immaterial.

When Assembly Bill 2075 incorporated refund and credit provisions for tobacco products into law, tobacco products returned by customers that are fit for use and salable were inadvertently overlooked. This measure would correct an oversight in drafting the credit and refund provisions contained in AB 2075.

In addition, Assembly Bill 2075 incorporated provisions for a refund of the excise tax paid on tobacco products, which is reported and paid on an excise tax return based on the wholesale cost of the tobacco products, into Revenue and Taxation Code Section 30177. Section 30177 was written to provide for a refund of the excise tax on cigarettes, which is paid through the application of a cigarette tax stamp to each package of cigarettes. While cigarette distributors report to the Board the number of cigarettes sold during a reporting period, the tax has already been paid through the application of the tax stamps. The excise tax on tobacco products, on the other hand, is paid through the use of a return on which the distributor reports the wholesale cost of the tobacco products distributed and calculates the tax due. The tobacco products distributor should be able to deduct from the wholesale cost on which the tax is based the cost of any returned tobacco products, rather than

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following the procedure established for cigarettes, on which tax is paid through the use of stamps rather than returns. In addition, the tobacco products distributor should be able to take a credit on the return, in lieu of claiming a refund, for taxes which were paid on tobacco products that were returned to the distributor. A similar credit in lieu of refund is available in most of the other tax programs administered by the Board.

3. **Suggested Technical Amendment.** Under current law, the Board is required to annually set a tax rate to be imposed upon the wholesale cost of tobacco products distributed by every distributor of tobacco products based on Sections 30123 and 30131.2 of the Revenue and Taxation Code. Section 30123, as proposed to be amended by this bill, would add subdivision (c) to provide that the wholesale cost used to calculate the amount of tax would not include the wholesale cost of tobacco products returned by a customer during the same reporting period the tobacco products were distributed. However, this bill does not amend Section 30131.2 to add the same language.

Accordingly, it is recommended that Section 30131.2 be amended to contain the same language as proposed Section 30123 to add consistency to the tax on tobacco products.

3. **Board staff does not foresee any administrative problems with this measure.** Allowing a distributor to claim a deduction, credit or refund for returned tobacco products would not affect the Board's administration of the Cigarette and Tobacco Products Law.
4. **Double joining language may be necessary.** AB 224 (Matthews and Migden) would also amend Section 30123 of the Revenue and Taxation Code. AB 224 would require the Board to develop a weight-based formula for determining the equivalent rate for the surtax on tobacco products.

As this bill progresses, the author may wish to consider adding double joining language to this measure.

## **COST ESTIMATE**

The administrative costs associated with this bill would be absorbable. These costs would include advising and answering inquiries from the public, revising returns and informing Board staff.

## **REVENUE ESTIMATE**

This measure would not impact the state's revenue. Distributors of tobacco products have been claiming, and the Board has been allowing, the credit for returned tobacco products as proposed by this bill.

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